HOUSE RESEARCH ORGANIZATION bill analysis 5/1/91

HB 2
Cavazos, Stiles et al.
(CSHB 2 by Cavazos, Stiles)

SUBJECT: Revising regulation of the insurance industry

COMMITTEE: Insurance: committee substitute recommended

VOTE: 8 ayes — Cavazos, Shea, Counts, Brimer, Hury, Martin, Stiles, Taylor

0 nays

1 absent — Pennington

WITNESSES: (On introduced version of HB 2):

For — Tim Curtis, Texas Citizen Action; John Hildreth, Consumers Union; Charlotte Flynn, Gray Panthers of Texas; Tom Smith, Public Citizen; Steven Hacker, Professional Insurance Agents of Texas.

Against — Robert Blevins, Texas Life Insurance Association; Edward Zimmerman, American Council of Life Insurance; Jay Thompson, AFACT; Donald Earthman, Mission Life Insurance Company; Robert Simpson, American Insurance Association; Will Davis, Texas Legal Reserve Officials Association; J.D. Williamson, Transport Life, Continental Life; Richard Lee, Life Insurance Company of the Southwest; Jack Wahlquist, Lone Star Life Insurance Co.; Robert Clines, Provident American Insurance Company; Cecil Nettle, Colonial Security Insurance Company; Joe Bailey, National Security Life and Accident Insurance Company; Joseph Boggins, American International Group Incorporated; Tim Salge, Farmers Mutual Comal County.

On — Gov. Ann Richards; Attorney General Dan Morales; Allene Evans, Attorney General's Office; Claire Korioth, Dick Reynolds, Tom Jackson, State Board of Insurance; Marcus Jenvold, Texas Surplus Lines Association; William Marcoux, alien reinsurers attorney; Peter Demmerle, surplus lines representative; Lottie Hodgkinson, County Mutual Association; William Daves, management consultant; Connie Hernandez, CRT operator; Robert Huxel, Independent Insurance Agents of Texas; Avrohm Wisenberg, Texas Association of Independent Lloyds; William Graves, Progressive County Mutual; Tom Bond, National Association of Fire & Casualty Companies; Eugene Palmer, Allstate Insurance Company;

Charles Wirth, State Farm Insurance; Dane Harris, Texas Association of Business; David Evans, Progressive County Mutual Insurance Company.

BACKGROUND: The State Board of Insurance (SBI) regulates the insurance industry in Texas. The SBI has the exclusive authority to set insurance rates for the major lines of insurance, including for motor-vehicle, general-liability and property. The board generally holds rate hearings annually for each type of insurance to review insurer earnings and losses. The board determines classifications within a particular type of insurance and the rates that an insurer may charge under each classification. For example, the SBI classifies motor vehicles according to risk and usage, then determines the rate to be charged under each category established. A deviation mechanism allows insurers to request deviation from rates set by the board.

Advisory organizations, which assist insurers and the SBI in gathering loss, expense and other rate-making data, must register with the SBI.

Insurers may sell insurance using only forms adopted by the SBI for each insurance line. The SBI establishes statistical plans used in rate-making, which are forms insurers must use to report required data.

The SBI has the authority to request the attorney general to sue insurers allegedly violating insurance laws or rules. Under a notification procedure, the attorney general must notify the board of alleged illegal activity before pursuing an investigation.

The regulated lines of insurance include:

General-liability insurance, which normally covers claims arising from the insured's liability for injuries or damage caused by ownership of property, manufacturing operations, contracting operations, sale or distribution of products, as well as professional services;

Property insurance, which generally provides financial protection against the loss of, or damage to, real personal property caused by specified perils;

Casualty insurance, which primarily covers the insured's liability for injuries to others or for damage to other persons' property; and

Title insurance, which generally covers the owner of real estate if clear ownership of property is challenged by the discovery of defects in the title.

An insurer may buy reinsurance from another insurer to assume liability for claims not covered by the insurer's assets.

Insurers are exempt from the state's antitrust laws, which generally prohibit restraint of trade and commerce.

DIGEST:

CSHB 2 would restructure the State Board of Insurance, change rate-making procedures, deregulate some rates, expand the powers of the consumer protection office in the agency and make numerous other changes in Texas insurance regulation.

The Texas Department of Insurance

Structure of the agency. The bill would combine the board, the commissioner, officers and employees of the State Board of Insurance into the Texas Department of Insurance. The department would continue to be administered by the commissioner under the supervision and direction of the board. The board would continue to issue the agency's rules.

Office of Public Insurance Counsel. The Division of Consumer Protection would be changed to the Office of Public Insurance Counsel. The powers of the office would be expanded so that it could:

• evaluate the impact of insurance rates, rules and forms for all lines of insurance, not just property and casualty insurance as under current law;

• intervene on behalf of consumers before the SBI on matters involving life, health, and accident insurance, and accident and sickness policy forms;

• initiate or intervene in court proceedings involving administrative actions in which the public counsel has appeared;

• appear or intervene on behalf of insurance consumers as a class in any proceedings the public counsel determines necessary, except in certain proceedings brought by the attorney general; and

• recommend legislation to the Legislature.

The public counsel could not intervene in SBI hearings that related to matters affecting individual insurers' licenses.

The office would be required to establish a consumer bill of rights to be distributed annually by insurers to each policyholder.

The office would be subject to the Texas Sunset Act and would have a sunset-review date of September 1, 1993.

New fees would be created for supporting the office. Certain insurers would be required to pay an annual three-cent fee for each individual policy of life, health and accident insurance granted during the year. Title insurers would be required to pay an annual 5.7-cent fee for each owner and mortgage policy of title insurance granted during the year.

Restricted employment in the industry. For two years after expiration or termination of service, commissioners, board members, general or public counsels, department heads and the highest paid agency employees could not represent anyone in a hearing before the board or be paid a salary for services regarding a case before the board. The prohibition would apply in perpetuity if the former employee or official was directly concerned with the case in question during the period of service. Violating this provision would be a class A misdemeanor (maximum penalty of one year in jail and a $2,000 fine).

Lobbyist registration. Anyone representing a client before the board more than twice annually would be required to register with the secretary of state.

Increased administrative fines. The bill would increase maximum fines for violating insurance rules or laws from $10,000 to $100,000. Fines for violating agency cease-and-desist orders, which currently range between $1,000 to $5,000, would be raised to a flat $100,000 for each violation.

Judicial review of SBI rulings. The substantial evidence rule would be applied to all appeals to state district court of SBI rulings and regulations;

the judge could consider only whether the board's decision violated a law, was justified by the evidence or was an abuse of discretion.

Rate-setting procedures

Flexible rating program. Between January 1, 1993 and December 31, 1995, insurers could charge premiums for motor-vehicle and personal property insurance according to a range of rates called a "flexibility band" set by the SBI for each of these markets of insurance. An insurer could charge rates beyond the SBI band only with board approval.

By September 1, 1992, the board would be required to hold a rate hearing to determine an initial benchmark rate on which the range of rates would be based. The initial benchmark rate would be used by insurers during the 1993 calendar year. The board would be required to hold rate hearings and set a benchmark rate annually. The board's range of rates in any year of the program would have to be within a range of plus or minus 30 percent of the established benchmark rate.

Insurers would be required to notify the SBI which rates they chose from within the SBI band, and those rates would become effective upon such notification. Along with the notification, insurers would be required to submit data justifying the rate chosen. Insurers writing one-half percent or more of a line of insurance under the program would be required to submit data of their own premium and loss history, which could be supplemented by data from licensed advisory organizations. To help meet data requirements, the board could designate advisory organizations to collect experience data from various insurers.

The board would have 60 days from notification to disapprove an insurer's request to charge beyond the allowable range of rates, or else the proposed rate would become effective.

In choosing a rate, an insurer could not take into account certain expenses, such as administrative costs exceeding 110 percent of the industry median, lobbying expenses, unrelated advertising and penalties for violations. Rates could not be excessive, inadequate or unfairly discriminatory. Changing a rate more than twice a year would require prior board approval.

The board would be required to adopt policy forms for each applicable line of insurance under the program. The board could approve policy forms and endorsement provisions adopted by national insurance organizations if the forms provided coverage identical to that provided in the board-adopted forms. The board could not adopt or approve a form for private-passenger-auto, personal-fire or homeowner's insurance that was not written in plain language.

Deregulation of rates. Between January 1, 1993 and December 31, 1995, insurers could set their own rates for general liability and commercial property insurance. Insurers would be required to file all rates with the SBI, along with supporting data justifying the rate. Rates could not be excessive, inadequate or unfairly discriminatory.

Insurers would be required to report quarterly to the SBI concerning changes in losses, premiums and market share since January 1, 1993. The board would be required to report quarterly to the governor and the Legislature concerning insurer-submitted information and market conduct, especially consumer complaints. Filings and supporting information would be considered public information.

Insurers could establish their own policy forms to be used for general liability and commercial property insurance. The forms would be required to be filed with and approved by the SBI. The board could disapprove a form only for certain reasons, including that the form contained ambiguous or deceptive language, that it was illegible, or that it violated requirements of this provision.

A mechanism would be provided for aggrieved policy holders or the public insurance counsel to request a board hearing concerning an insurer's rates. The board could nullify an insurer's filed rate upon a finding that provisions of this section of the bill were not met.

Among the stated purposes for deregulation would be to authorize essential cooperative action among insurers and regulate that activity to prevent practices that substantially lessen competition or create a monopoly.

Advisory organizations. The bill would require advisory organizations to be licensed by the SBI before insurers could use their services. The board would issue a license upon a finding that the applicant was trustworthy and qualified to provide the services proposed to be offered.

An advisory organization could perform such services as using statistical plans promulgated by the SBI to collect insurers' premium loss histories, conducting research for gathering statistical data required in the board's statistical plans, and developing policy forms that could be used by insurers. Advisory organizations specifically could not engage in monopolizing or boycotting an insurance market, or in acting with others to restrain trade or reduce competition in the insurance industry.

The board would be required to audit advisory organizations that provided data in a rate-setting hearing.

Statistical plans. The board would be required to establish rules relating to statistical plans. (Current law requires the board to establish rules and statistical plans regarding rate-setting data.)

Insurance cancellation, renewal and withdrawal

The bill would limit cancellation, nonrenewal and insurer-withdrawal of policies for personal auto, personal-property owner, governmental property and casualty and certain fire insurance.

Cancellation. An insurer could cancel policies for the specified lines of insurance only if the insured failed to pay a premium or submitted a fraudulent claim, or if continuation of the policy violated insurance laws. Additionally, insurers could cancel an auto policy if the driver's license or registration of an insured were suspended or revoked; and other lines could be canceled if there were an increase in the hazard covered by the policy.

Renewal. Insurers could not refuse to renew a personal auto policy solely because of the insured's age; nor could they fail to renew a personal-property or a standard-fire policy solely because a claim had been filed for which the insured was not negligent. However, insurers could refuse to renew any policy for which over three claims were filed in any three-year period.

Insurers could apply board-mandated surcharges for renewing personal-property and fire policies that had over one claim filed in the preceding policy year. Surcharges could not exceed 10 percent of the total premium.

Withdrawal from insurance market. Insurers proposing to withdraw from a particular line of insurance would be required to submit a five-year plan of withdrawal for the approval of the commissioner. The commissioner could require that the insurer's securities be held in trust to protect the interests of the state, and insurers could not resume writing the line from which they were withdrawing for three years.

Insurance fraud unit

The bill would create an insurance fraud unit within the department to investigate insurance fraud and assist in enforcing insurance anti-fraud laws. Discovered fraudulent insurance acts would have to be reported in writing to the commissioner, board or authorized government agencies. The commissioner, board and designated officers would have the authority to subpoena witnesses and evidence under investigation, and the commissioner could keep information confidential.

Immunity from liability would be granted to those acting without malice, fraud or bad faith for furnishing information regarding fraudulent insurance acts, if provided to the proper authorities.

Other provisions

Antitrust laws applied. The state antitrust laws would be applied to insurers.

Proof of insurance. Motorists would be required to provide proof of auto liability insurance when submitting a motor-vehicle registration application.

Independent audits. Insurers could no longer automatically claim a financial-hardship exception to the requirement that insurers be audited annually. The financial-hardship exception would be initiated only at the commissioner's discretion. The commissioner would be prohibited from granting an exception to insurers for various reasons, including being under supervision or disciplinary action.

Capital and surplus requirements. The commissioner could order insurers who fail to comply with statutory minimum levels of capital and surplus to cease writing new business. The board could require newly incorporated companies to maintain capital and surplus levels beyond the statutory minimum levels generally required.

Prompt payment of claims. Insurers would be required to acknowledge and begin investigating direct claims within 15 business days of notification. Within 15 days after receiving the required information, an insurer would be required to notify the claimant whether the claim were accepted or rejected. An accepted claim would be required to be paid within five business days of notice of acceptance.

Attorney general authority. The attorney general would be given direct authority to sue insurers allegedly violating insurance laws or rules.

Revocation or refusal of license. The board would be required to refuse to license, and could revoke the license or certificate of authority of, an insurer convicted of a felony involving either moral turpitude or breach of fiduciary duty. A mechanism would be provided to reinstate insurers' authority to do business five years after final conviction.

Consumer hot lines. The department would be required to establish a toll-free hot line to provide insurance information to the public, including information on insurer ratings, complaints received and types of coverage available. Insurers with at least $1 million in annual gross premium receipts would be required to maintain a toll-free hot line to provide the public with information on policies issued and to accept policyholder complaints.

Public representation. At least half the membership of various advisory groups appointed by the board or the commissioner would be required to represent the general public. General-public members could not be, nor be related to, registered lobbyists or employees of board-regulated businesses.

Reinsurance Intermediary Act. This provision would require reinsurance intermediaries, who act as brokers and managers between insurers and reinsurers, to obtain a license from the commissioner. The bill would outline licensing procedures, fees and accepted conduct.

SUPPORTERS SAY:

CSHB 2 would put teeth into regulation of the insurance industry and give consumers an active voice in industry oversight. It would help stabilize skyrocketing insurance rates and ensure the continued solvency of insurance companies at a time when state auditors have concluded that 283 insurance companies operating in Texas are in financial trouble. It would help lower personal auto insurance rates, which have just been hiked by the board. The well-publicized insolvencies of many Texas insurers have been a blow to the state matched only by the ineffectiveness of the board to regulate the industry; this bill would tackle such problems in a just and equal compromise that would benefit all interested parties.

The consumers' division would be expanded and transformed into a meaningful arm of the agency. Public representation would be increased, giving consumers an equal voice in setting rates as well as regulating the industry. Public representation on various advisory groups within the department would be increased, which would be totally independent from the industry.

Increasing administrative penalties, establishing an anti-fraud unit and granting the attorney general independent authority to pursue legal action against insurers would greatly reduce illegal activity. Closing the revolving door now open to SBI commissioners and employees who leave the regulatory agency to work for the industry would prevent insurer manipulation of the regulatory agency.

Insurers would be prevented from manipulating consumers and would have to distribute a consumer bill of rights created by the department. The bill would force prompt payment of claims and prevent companies from leaving policyholders stranded by abruptly pulling out of the state or canceling policies. Information hot lines would give consumers the tools to make informed decisions and register complaints.

Bringing insurers under the state's anti-trust laws would provide additional protection against price-fixing and other anti-consumer practices. As a regulated industry, insurers escape the anti-trust prohibitions that are imposed on other businesses. Consequently, they can share and manipulate data on prices before presenting it to the SBI for rate approval. The state should not tie its own hands by limiting itself to reliance on the insurance regulations in the Insurance Code to police the industry.

Insurers could not circumvent antitrust laws under this bill. Any data collected by insurer advisory organizations would be audited by the board and provisions would allow the board to begin collecting independent data from individual companies. Creating an independent data system from the outset, however, would be too expensive. The prohibition against excessive and discriminatory rates, the requirement that policy forms for personal lines of insurance use plain language and the strict licensing of advisory organizations would further safeguard against insurer collusion.

Data and financial requirements in the bill would ensure the continued solvency of insurance companies and give the department the tools to pinpoint troubled companies before they go under. The board could require individual companies to keep higher minimum levels of capital and surplus than is normally required. No longer could insurers refuse to submit to financial audits simply by claiming that doing so would be a financial hardship; financially troubled companies are precisely the ones that should be targeted for audits.

The bill would help stabilize skyrocketing insurance rates for consumers while providing greater rate-setting flexibility for insurers to respond to consumer needs. The flexible-rating and deregulation provisions would encourage straightforward competition in the marketplace by allowing insurers to deviate from a benchmark rate without prior board approval. Repeal of the anti-trust exemption would help stabilize rates by reducing insurer manipulation of the market. Larger insurers would be required to submit independent data, allowing the board to consider insurer profits and losses before they could be distorted by insurer rating organizations. Also, insurers could not inflate personal-line expenses reported to the board for costs unrelated to those types of coverage.

Requiring motorists to provide proof of auto insurance before acquiring their license plates would help reduce private auto-insurance rates, which have just been raised by the board by an average of 8.7 percent, or $362 million. Claims for uninsured motorists would be considerably reduced and the policyholder pool for auto insurance would markedly increase.

Applying the substantial-evidence rule to appeals of SBI rulings would conform the agency statute to current case law.

OPPONENTS SAY:

This bill falls far short of genuine insurance reform. It would expand the insurance industry's ability to raise rates without adequately balancing consumer needs. Under the rate flexibility band, insurers could subject consumers to arbitrary treatment. Giving insurers control over policy forms would allow them to confuse consumers. Application of the antitrust laws to insurers would be nullified by other provisions in the bill and do nothing to reduce insurance rates.

The broad language found in the deregulation provisions would allow insurers to protect their financial positions to the detriment of consumers. Insurers should be specifically prohibited from setting rates that are "excessive *for the coverage provided*, unfairly discriminatory *to the public*, or inadequate."

Giving insurers the authority to choose their own rates for individual policies under the flexible rating plan would expose consumers to arbitrary classifications. Under the bill, insurers could decide whether to charge a person above or below a standard rate, which is often based on territory, age and other factors. Even though certain practices are illegal, keeping such rating decisions under the exclusive authority of the board now at least ensures that consumers are protected from discrimination.

Allowing insurers to write their own policy forms would severely hamper consumers from shopping comparatively for insurance. Under current law the board establishes for each type of insurance a unique form that all insurers must use, allowing consumers to compare policies side by side, line by line. Policies written in "plain language" could still be confusing and difficult to compare if coverage were expressed using varied terms; a policy's plain language would be far less useful if insurers are allowed to write their own policy forms.

The bill's application of antitrust laws to insurers would be virtually nullified by other provisions. Insurers would be allowed to collect and share rate-setting data through the use of advisory organizations and could jointly develop policy forms, thus granting advisory organizations an official capacity in the rate-setting process. Also, the bill expressly intends "to authorize essential cooperative actions among insurers" in the deregulation of general liability and commercial-property insurance. This language would give insurers a back-door method of circumventing antitrust laws.

Granting official status to advisory organizations also would nullify any provisions aimed at reducing insurance rates. By using these organizations to share information that would be submitted in rate hearings, insurers would still retain the ability to manipulate rates rather than being required to operate in a truly competitive environment.

Provisions in the bill could cause the board to receive from insurers confusing and inconsistent data used in rate-setting. The bill appears to remove the board's authority to establish *statistical plans*, giving insurers the opportunity to submit data using their own forms. The board would be forced to decipher data from varied, nonstandard forms, rather than one standard form.

Insurers should be prohibited from selectively refusing to sell coverage in Texas that they offer out-of-state. Insurer boycotting of the state leaves consumers stranded and diminishes competition and risk-sharing among insurers.

Insurers should not be allowed to "withdraw from within" a single line of insurance. The withdrawal provision in the bill would permit an insurer to target a single type of insurance and reduce the number of policies in that line, a step short of completely withdrawing the line.

The revolving-door provision on agency employees is too weak; it would allow former agency employees to engage in activities such as lobbying for pro-insurer legislation and rules, as long as these were not related to a case pending before the board.

OTHER OPPONENTS SAY:

The current exemption from the antitrust laws for the insurance industry should not be changed. Current law does not exempt insurers from engaging in boycotts, coercion, intimidation or price-fixing. It would be contradictory to apply sanctions against a regulated industry under one law (antitrust) for abiding by the provisions of another (the Insurance Code and SBI rules).

This bill would unjustifiably increase state bureaucracy. The revised fiscal note estimates that 90 state employees would have to be hired in the first year alone, causing the continued swelling of this agency's ranks.

NOTES:

The committee substitute made substantial revisions to the original version of HB 2. Among the highlights, the original version contained an "anti-boycott" provision that would have required insurers to sell all lines of insurance in Texas that they sell in other states; in the substitute, a withdrawal provision would require insurers to file a plan with the board before withdrawing a line of insurance.

The original version would have required the SBI to be the data-collection center for rate-making statistics for automobile, property and general liability insurance. It would have removed provisions allowing rating organizations to collect data considered by the board in setting rates. Insurance policy forms would have continued to be established exclusively by the board; insurers could have used their own endorsement forms for additional coverage upon board approval.

The Senate companion bill, SB 2 by Parker and Montford, identical to HB 2 as filed, is pending in the Senate Economic Development Subcommittee on Insurance.

A related bill, SB 1492 by Glasgow, would revise the regulation of insurance. SB 1492 would repeal the current Insurance Code and enact a new code. A nine-member insurance rate commission would establish a base rate for all lines of insurance, from which insurers could deviate within a commission-established range. Deviation from the established range would be permitted only with approval from the division of solvency or after an administrative hearing. A schedule of rate hearings for each line of insurance would be established.

All data used to establish rates would be gathered by an independent "databank of insurance research." The independent databank also would establish all policy forms, as well as conduct insurance research.

A nine-division consumer insurance control bureau, headed by a director of insurance regulation, would protect insurance consumers, license and regulate insurers, identify and address companies in financial difficulty, resolve insurance conflicts, investigate fraud, establish fee schedules, and help consumers obtain insurance.

SB 1492 is pending in the Senate Economic Development Subcommittee on Insurance.